

# Recent Developments Affecting Depository Institutions

by Lynne Montgomery\*

## REGULATORY AGENCY ACTIONS

### *Interagency Actions*

#### *Consumer-Protection Rule for Insurance*

The federal bank and thrift regulatory agencies announced on December 4, 2000, a final consumer-protection rule for the sale of insurance products by depository institutions. The rule outlines disclosures that are required before the completion of the sale of an insurance product or annuity. The rule applies to any depository institution and any person selling, soliciting, advertising, or offering insurance products or annuities to a consumer at an office of the institution or on behalf of the institution. The disclosures must be made orally and in writing, and the consumer must acknowledge in writing that the disclosures were received. The final rule, which is effective October 1, 2001, implements Section 305 of the Gramm-Leach-Bliley Act. *PR-87-2000, FDIC, 12/4/00.*

#### *CRA Sunshine Regulation*

On December 21, 2000, the federal bank regulatory agencies approved a final regulation that governs how banks and community organizations disclose their community lending agreements. The rule implements the CRA Sunshine Requirements of the Federal Deposit Insurance Act, which were enacted by the Gramm-Leach-Bliley Act. The rule requires banks and thrifts to make available for public disclosure agreements they have with community groups

and other organizations in connection with compliance under the Community Reinvestment Act. The rule also requires banks and thrifts to send copies of such agreements to the appropriate banking regulator. The rule, which was issued by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Office of Thrift Supervision (OTS), becomes effective April 1, 2001. *NR 2000-105, OCC, 12/21/00; BBR, 1/8/01, p. 9-10.*

#### *Customer Information Security Guidelines*

The federal bank and thrift regulatory agencies adopted guidelines for safeguarding confidential customer information. The purpose of the safeguards is to ensure the security and confidentiality of customer records and information. The guidelines implement Section 501(b) of the Gramm-Leach-Bliley Act and are effective July 1, 2001. The guidelines require financial institutions to establish an information security program to: (1) identify and assess the risks that may threaten customer information; (2) develop a written plan containing policies and procedures to manage and control these risks; (3) implement and

\*Lynne Montgomery is a senior financial analyst in the FDIC's Division of Research and Statistics.

Reference sources: American Banker (AB), Federal Register (FR), and BNA's Banking Report (BBR).

test the plan; and (4) adjust the plan on a continuing basis to account for changes in technology, the sensitivity of customer information, and internal or external threats to information security. The guidelines also outline responsibilities of directors of financial institutions in overseeing the protection of customer information. *OTS 01-04, OTS, 1/17/01.*

### ***Debt Requirements for Banks that Own Financial Subsidiaries***

On January 22, 2001, the Federal Reserve Board and the Treasury Department approved a final rule that sets the criteria that a specific class of national banks and state-member banks must meet to own financial subsidiaries. A national bank or a state-member bank wishing to control a financial subsidiary must rank as one of the 100 largest insured banks in the nation. The largest 50 banks in that group may control a financial subsidiary if their long-term debt receives a top investment-grade rating. The remaining 50 banks in the group also may control financial subsidiaries by meeting this long-term debt requirement or by meeting an alternative debt requirement, which is the focus of the final rule. The final rule allows the second group of 50 banks to meet the requirement if they have a current long-term issuer credit rating from a nationally recognized statistical rating organization that is within the three highest investment-grade categories used by the rating organization. In addition to the debt requirement, national and state-member banks must meet capital, management, and other requirements to operate financial subsidiaries. *BBR, 1/29/01, p. 131.*

## ***Federal Deposit Insurance Corporation***

### ***Tanoue Resigns***

On July 11, 2001, Donna Tanoue resigned from the FDIC, where she served as chairman since May 26, 1998. Under Ms. Tanoue's leadership, the FDIC conducted a review of the deposit-insurance system and proposed important changes to the federal deposit-insurance program. The Corporation also addressed the risk of subprime lending and initiated proposals to address the problems of predatory and payday lending. Before coming to the FDIC, Ms. Tanoue was a partner in the Hawaii law firm of Goodsill Anderson Quinn & Stifel. *PR-45-2001, FDIC, 6/12/01; BBR, 6/18/01, p. 1022.*

### ***Board Member Appointed***

John M. Reich was sworn in on January 16, 2001, to a six-year term as a Director on the FDIC's Board of Directors. Before joining the FDIC, Mr. Reich served for 12 years on the staff of U.S. Senator Connie Mack (R-FL), where he was the chief of staff from 1998 through 2000. Mr. Reich directed and oversaw all committee activity, including Senator Mack's activity on the Senate Banking Committee. Before working with Senator Mack, Mr. Reich spent 23 years in the banking business in Illinois and Florida. *AB, 12/19/00.*

### ***Final Regulation on State Banks' Activities and Investments***

The FDIC released a final regulation on December 21, 2001, governing how the agency approves activities and investments of insured state-chartered banks. The rule was required by the Gramm-Leach-Bliley Act (GLBA), which created a new Section 46 of the Federal Deposit Insurance Act. Section 46 outlines the FDIC's approval procedures for various activities of state nonmember banks. Before GLBA, approvals of state-bank activities were handled under Section 24 of the Federal Deposit Insurance Act. The final rule permits state banks to seek approval under either Section 24 or Section 46. In addition, the final rule grandfathers activities by a state bank that has already received approval under Section 24, if the Treasury Department and the Federal Reserve Board have not already made certain other determinations under Section 46. The final rule also eases the approval process by permitting banks to enter into a new activity as soon as the FDIC receives notice from the bank that it complies with all requirements for that activity. *BBR, 1/8/01, p. 15.*

### ***Money Smart Program***

The FDIC and the Department of Labor announced on January 1, 2001, a joint initiative called *Money Smart*, which offers basic financial education to people taking part in Welfare-to-Work and Workforce Investment Act programs nationwide. *Money Smart* consists of 10 training modules covering basic financial education topics. The program is designed to help adults currently outside the financial mainstream build financial knowledge and develop positive relationships with financial institutions. Beginning in the second quarter of 2001,

*Money Smart* will be available through a national network of more than 800 centers that provide employment and training services for persons seeking new jobs or entering the workforce, including individuals participating in Welfare-to-Work programs. *PR-6-2001, FDIC, 1/19/01.*

### ***Report on Underwriting Practices***

The October 2000 issue of the FDIC's semiannual *Report on Underwriting Practices* reported a slight increase in the occurrence of risky underwriting practices for construction, commercial (nonresidential) real-estate, and home-equity lending during the six-month period ending September 30, 2000. The risks associated with current underwriting practices, loan growth, and credit risk in banks' loan portfolios also increased during the six-month period. In contrast, the occurrence of risky underwriting practices for agriculture lending decreased. The survey of loan underwriting practices is aimed at providing early warnings of potential problems in underwriting practices at FDIC-supervised, state-chartered nonmember banks. The focus of the survey is threefold: material changes in underwriting standards for new loans, degree of risk in current practices, and specific aspects of the underwriting standards for new loans. The October report includes surveys from 1,124 FDIC-supervised banks that were examined during the six months ending September 30, 2000. *Report on Underwriting Practices, FDIC, October 2000.*

In the April 2001 issue of the *Report on Underwriting Practices*, the FDIC reported that the occurrence of risky underwriting practices by banks increased for both construction and consumer lending, but the risks associated with general underwriting practices decreased slightly. The April report summarizes responses from FDIC examiners to survey questions regarding the lending practices at 1,181 FDIC-supervised banks examined during the six-month period ending March 31, 2001. *Report on Underwriting Practices, FDIC, April 2001.*

### ***Real-Estate Survey—July 2000***

The July 2000 issue of the *Survey of Real Estate Trends* reported continued favorable views of local residential and commercial real-estate markets. Survey respondents were asked if general conditions for U.S. real-estate markets had changed (as characterized by vacancy rates, market prices, and the pace of sales) in the first six months of 2000. The per-

centage of respondents reporting no change was high across all property markets: single-family (58 percent), multifamily (72 percent), office (72 percent), retail (78 percent), and industrial (73 percent). Where general market conditions were reported to have changed, improving conditions were observed more often than worsening conditions. The July report summarized the opinions of 256 survey respondents, which consisted of FDIC senior examiners and asset managers as well as bank examiners of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. *Survey of Real Estate Trends, FDIC, July 2000.*

### ***Real-Estate Survey—January 2001***

The January 2001 issue of the *Survey of Real Estate Trends* reported that conditions generally remained favorable in the nation's real-estate markets during the second half of 2000, although there was some deterioration, particularly involving single-family homes and local retail properties. The percentage of respondents reporting no change in the condition of U.S. real-estate markets was high across all property markets: single-family (56 percent), multifamily (75 percent), office (69 percent), retail (75 percent), and industrial (76 percent). However, reports of slight deterioration in conditions were more frequent than those of improvement for all property markets except industrial. This development was in contrast to the first half of 2000 when reports of improving conditions outnumbered those of worsening ones. Single-family markets had the highest proportion of respondents noting somewhat worsening conditions—27 percent of respondents reported worsening conditions *versus* 17 percent reporting better conditions. Eighteen percent of respondents reported deterioration in local retail markets, while only 7 percent reported better conditions. The January report summarized the opinions of 265 survey respondents, which consisted of FDIC senior examiners and asset managers as well as bank examiners of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. *Survey of Real Estate Trends, FDIC, January 2001.*

### ***Insurance Funds' Financial Results for 2000***

The FDIC reported that the Bank Insurance Fund (BIF) experienced comprehensive income (net

income plus unrealized gains/losses on available-for-sale securities) of \$1.6 billion for the 12 months ending December 31, 2000, compared to a loss of \$198 million during 1999. At December 31, 2000, the BIF balance was approximately \$31 billion, up from \$29.4 billion at year-end 1999. The increase in income was primarily attributable to low estimated losses recognized on institutions that failed in 2000 and an increase in the market value on available-for-sale securities. BIF revenues totaled \$1.9 billion in 2000, including \$1.8 billion in interest on investments in U.S. Treasury obligations and \$45 million in deposit insurance assessments. The Savings Association Insurance Fund (SAIF) reported comprehensive income of \$478 million in 2000, compared to \$441 million in 1999. The SAIF closed the year with a fund balance of \$10.8 billion, an increase from \$10.3 billion at year-end 1999. The SAIF earned \$664 million in revenue during 2000, consisting of \$644 million in interest on investments in U.S. Treasury obligations and \$19 million in deposit insurance assessments. *PR-29-2001, FDIC, 4/10/01.*

### **Bank Failures**

On September 29, 2000, Mississippi's Commissioner of Banking and Consumer Finance closed the Bank of Falkner, Falkner, Mississippi, and named the FDIC as receiver. The Bank of Falkner had total assets of approximately \$88.8 million and deposits of \$77.1 million in approximately 5,827 accounts. Citizens Bank & Savings Company, Russellville, Alabama, paid a premium of \$2.5 million to purchase the failed institution's insured deposits and approximately \$21.7 million of the assets. The FDIC retained the remaining assets for later disposition. The Bank of Falkner is the fourth failure of a BIF-insured institution in 2000. *PR-66-2000, FDIC, 9/29/00.*

Hawaii's Commissioner of Financial Institutions closed the Bank of Honolulu, Honolulu, Hawaii, on October 13, 2000, and the FDIC was named receiver. The failed institution had total assets of approximately \$66.9 million and total deposits of \$59.5 million in approximately 5,900 accounts. The Bank of the Orient, San Francisco, California, paid the FDIC a premium of \$1 million to assume the failed bank's insured deposits and paid an additional premium of \$855,000 to purchase approximately \$52.2 million of the failed bank's assets. Additionally, the Bank of the Orient was given a 30-day exclusive purchase option on another \$9.3 million of the failed

bank's assets. The FDIC retained the remaining assets for later disposition. The FDIC estimates that the failure will cost the BIF approximately \$2.5 million. The Bank of Honolulu is the fifth failure of a BIF-insured institution in 2000. *PR-70-2000, FDIC, 10/13/00.*

National State Bank, Metropolis, Illinois, was closed by the Office of the Comptroller of the Currency (OCC) on December 14, 2000, and the FDIC was appointed receiver. The OCC used its authority under the FDIC Improvement Act of 1991 (FDICIA) to close the bank when it discovered that the bank was critically undercapitalized—the bank's tangible equity capital was less than 2 percent of its total assets. Inadequate control of the credit and transaction risks associated with its merchant-processing activities involving the settlement of credit-card-sales transactions for merchants resulted in a high volume of losses, which depleted capital and threatened the bank's liquidity. The FDIC entered into an agreement with Banterra Bank, Marion, Illinois, to assume the insured deposits of the failed bank, which were approximately \$67 million at the time of closing. Banterra Bank also paid the FDIC a premium of approximately \$2 million for the right to purchase \$23.7 million of the failed bank's assets. The FDIC retained the remaining assets of approximately \$68 million for later disposition. This is the sixth failure of a BIF-insured institution in 2000, and the seventh failure of an institution insured by the FDIC in 2000. *PR-90-2000, FDIC, 12/14/00.*

On February 2, 2001, the Bank Commissioner for the state of New Hampshire closed First Alliance Bank & Trust Company, Manchester, New Hampshire, and the FDIC was named receiver. The failed bank had approximately \$18.4 million in assets and \$17.5 million in deposits. Southern New Hampshire Bank & Trust, Salem, New Hampshire, paid the FDIC a premium of \$150,000 for the right to assume the deposits and to purchase \$17.1 million of the failed bank's assets. The FDIC retained the remaining \$1.3 million of assets for later disposition. The FDIC estimates this transaction will cost the BIF approximately \$119,000. First Alliance is the first failure of a BIF-insured institution in 2001. *PR-11-2001, FDIC, 2/2/01.*

On May 3, 2001, the OCC closed The Malta National Bank, Malta, Ohio, and appointed the FDIC as receiver. The OCC used its statutory receivership authority to close the bank after finding



that the bank had engaged in unsafe-and-unsound practices and had incurred significant losses. The failed bank had total deposits of approximately \$8.8 million and total assets of \$9.5 million. The FDIC entered into an agreement with North Valley Bank, Zanesville, Ohio, to assume all of the failed bank's deposits. North Valley Bank also purchased \$9.2 million of the failed bank's assets at a discount of approximately \$800,000 from book value. The FDIC retained the remaining assets for later disposition. The FDIC estimates the transaction will cost the BIF approximately \$80,000. This was the second failure of a BIF-insured institution in 2001.

*PR-32-2001, FDIC, 5/3/01.*

## Federal Reserve Board

### Interest Rates

Between January 3, 2001, and June 27, 2001, the Federal Open Market Committee (FOMC) lowered the targeted federal funds rate by 275 basis points, decreasing the rate from 6.50 percent to 3.75 percent. The Board of Governors decreased the discount rate by 275 basis points during the same time period, lowering the rate from 6.00 percent to 3.25 percent. The federal funds rate is the fee that banks charge each other for overnight loans, and the discount rate is the fee charged to financial institutions for borrowing from their district Federal Reserve Banks. *PR-FRB, 1/3/01, 1/31/01, 3/20/01, 4/18/01, 5/15/01, 6/27/01.*

### Regulation Z

The Federal Reserve Board adopted a final rule aimed at helping consumers decipher credit-card companies' marketing pitches about interest rates, late fees, grace periods, and other terms. The rule amends Regulation Z, which implements the Truth in Lending Act, to revise the disclosure requirements for credit-card solicitations and applications. Under the new rule, credit-card issuers will have to include an easy-to-read chart on all credit-card solicitations and applications, laying out in simple terms the interest rate consumers will pay to carry debt on the card. The rule comes in response to rising concern among bank regulators about overly aggressive marketing tactics by credit-card issuers that can confuse consumers and make credit-card purchases more expensive than anticipated. The rule is effective September 27, 2000, and compliance is mandatory as of October 1, 2001. *The Washington Post, 9/29/00; FR, 10/3/00.*

## Assessment of Foreign Banks' U.S. Operations

On October 24, 2000, the Federal Reserve announced a series of steps to update its five-year-old system of supervising foreign banking organizations that operate in the United States. The Federal Reserve plans to improve its "Strength of Support Assessment" (SOSA) process, through which it ranks foreign banks' ability to offer financial, liquidity, and management support to its American operations. The rankings help provide a point of reference for U.S. bank supervisors to assess the risks of a foreign bank's operations in the United States. Under the new system, the five current SOSA rankings will be streamlined into three rankings. The new initiative provides that the Federal Reserve will inform foreign banking organizations, as well as the banks' home-country supervisors, of the SOSA rankings. In addition, the new initiative calls for the creation of a combined assessment rating for all of a foreign banking organization's U.S. branches, agencies, and commercial lending companies. *BBR, 10/30/00, p. 545.*

## New Annual Reserve and Reporting Requirements

On November 21, 2000, the Federal Reserve Board published in the Federal Register annual adjustments used to calculate reserve requirements and reporting requirements for depository institutions. The reserve requirements determine how much depository institutions must keep on hand either in cash, deposits at Federal Reserve Banks, or pass-through accounts at correspondent institutions. For the year 2001, the first \$5.5 million in net transaction accounts will be exempt from the reserve requirements. Amounts between \$5.5 million and \$42.8 million will be subject to a 3 percent requirement, and amounts above \$42.8 million are subject to a 10 percent reserve requirement. Effective September 2001, institutions must file reports on their deposit levels on a weekly, quarterly, or annual basis, depending on their deposit levels and their classification with respect to reserve requirements. However, U.S. branches and agencies of foreign banks must file deposit reports weekly, regardless of their size. *BBR, 11/27/00, p. 681.*

## Financial Holding Companies Permitted to Offer Finder Services

On December 13, 2000, the Federal Reserve

Board approved a rule defining “finder” activities as financial in nature and therefore within the bounds of banks’ legitimate business functions. A “finder” acts as an intermediary in a transaction that is negotiated between the buyer and seller, and facilitates the identification of the potential buyers and sellers. The rule, which amends Subpart I of Regulation Y, requires banks acting as finders to differentiate clearly between products and services they offer directly and those that are offered by third parties. Under the rule, financial holding companies acting as a finder can: identify third parties that may be interested in engaging in a transaction between themselves; ask third parties about their interest in engaging in a transaction with another party; introduce and refer potential parties to each other; arrange contacts and meetings between interested parties; and transmit information concerning products and services to potential parties in connection with the above activities. *BBR*, 12/18/00, p. 783.

### ***Disclosure of ATM Fees***

The Federal Reserve Board published a final rule amending Regulation E (Electronic Fund Transfers) to implement provisions of the Gramm-Leach-Bliley Act requiring disclosure of automated-teller machine (ATM) fees. Under the final rule, an ATM operator who imposes a fee on a consumer for an electronic-fund-transfer service is required to provide notice of the fee in a prominent and conspicuous location on or at the ATM where the electronic service is initiated. The ATM operator also must disclose the amount of the fee either on the screen of the ATM or on a paper notice before the consumer is committed to completing the transaction. A fee may not be imposed unless proper notice is provided and the consumer chooses to complete the transaction. The rule is effective March 1, 2001, and compliance with the rule is mandatory as of October 1, 2001. *PR-FRB*, 3/1/01.

### ***HMDA Reporting Exemption Threshold Increased***

The Federal Reserve Board raised the asset-size exemption threshold from \$30 million to \$31 million for depository institutions that are required to report data under the Home Mortgage Disclosure Act (HMDA). In 2001, depository institutions with assets of \$31 million or less will be exempt from reporting data on their housing-related lending activ-

ities. The final rule amends Regulation C, which implements the Home Mortgage Disclosure Act. The asset level that releases institutions from reporting data under HMDA is adjusted each year on the basis of changes in inflation as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers. *NR* 2001-10, *OCC*, 2/20/01.

### ***Daylight Overdrafts***

On May 30, 2001, the Federal Reserve issued an interim rule permitting banks to accumulate negative balances in their accounts with the Federal Reserve during the course of the business day. The regulation, which is effective upon issuance, allows banks to seek “daylight credit” above their normal overdraft caps. The action reflects ongoing efforts by the Federal Reserve Board to balance the costs, risks, and benefits associated with the provision of Federal Reserve intraday credits. *Dow Jones Newswires*, 5/31/01.

### ***Survey on Bank Lending Practices***

In its May 2001 *Senior Loan Officer Opinion Survey on Bank Lending Practices*, the Federal Reserve Board reported that both domestic and foreign banks were continuing a trend of stricter business lending practices. Slightly more than 50 percent of domestic banks reported tightened standards for commercial and industrial (C&I) loans to large and middle-market firms since the last survey in January 2001. About 36 percent of domestic banks tightened standards on loans to small firms over the same period. Both foreign and domestic institutions indicated that the most important reasons for tightening standards and terms on C&I loans were a less favorable economic outlook and a worsening of industry-specific problems. For the report, the Federal Reserve surveyed loan officers from 55 large domestic banks and 21 U.S. branches and agencies of foreign banks. The survey focused on changes during the preceding three months in the supply and demand for bank loans to households and businesses. *Senior Loan Officer Opinion Survey on Bank Lending Practices*, FRB, May 2001.

## ***Office of the Comptroller of the Currency***

### ***Fees for Third-Party Exams***

A rule issued on May 8, 2001, permits the OCC to charge for special examinations of banks’ third-party service providers. Some banks recently have entered

new lines of business, or introduced potentially high-risk products, relying substantially on third-party service providers to enable the bank to conduct the activities. Since banks involved in such activities may be exposed to higher-than-normal levels of risk, examiners have an increased need to examine the third-party providers. The new rule, which becomes effective June 7, 2001, applies to a wide range of activities, including credit-card issuing, subprime lending, and check cashing. Before the rule, the OCC was permitted to assess a fee for a special examination of a bank, but not for special examinations of a third-party provider. *AB, 5/9/01.*

### ***Pilot Program to Enhance National Banks' Lending Capacity***

The OCC announced on June 8, 2001, a three-year pilot program intended to reduce the competitive disparity that exists in states that have single-borrower lending limits that are higher than the federal limits available to national banks. National banks are generally permitted to lend no more than 15 percent of their capital on an unsecured basis to a single borrower; however, many states have higher limits for their state-chartered institutions. The pilot program will allow national banks with the highest supervisory ratings to lend up to the state limit—but not more than 25 percent of capital—to single borrowers for small-business loans and for loans secured by single-family-residential real estate. Because the program is aimed primarily at community banks, only banks with assets of less than \$1 billion are able to participate. To participate in the program, a bank must be rated 1 or 2 under the five-point Uniform Financial Institutions Rating System scale, which evaluates an institution's capital adequacy, asset quality, management capability, earnings strength, liquidity, and sensitivity to market risk. Eligible banks must also have a rating of at least 2 for the asset and management components of the test. *NR 2001-52, OCC, 6/8/01.*

### ***Survey of Credit Underwriting Practices***

The OCC's annual *Survey of Credit Underwriting Practices* reported that underwriting standards for commercial and retail loans tightened during the 12-month period ending March 31, 2001. Fifty-five percent of banks tightened commercial loan standards in 2001, compared to 25 percent in 2000; 6 percent loosened standards in 2001, compared to 16 percent in 2000. The survey found that 32 percent of banks

tightened underwriting standards for retail loans, while 20 percent eased standards. The 2001 survey covered the 66 largest national banks with an aggregate loan portfolio of \$2 trillion—approximately 90 percent of national bank loans. The survey, which is completed by OCC senior examiners, consists of a series of questions concerning 16 types of commercial and retail lending. The questions focus on the direction of lending standards and the level of inherent risk in the portfolio and products of the banks. *NR 2001-59, OCC, 6/27/01.*

## ***Office of Thrift Supervision***

### ***Seidman Offers Resignation***

On July 3, 2001, Ellen Seidman announced that she submitted her resignation as the Director of the Office of Thrift Supervision (OTS). Her resignation is effective upon the confirmation and appointment of a replacement. Ms. Seidman has served as the Director of the OTS since October 27, 1997. Before becoming director, Ms. Seidman was a Special Assistant to President Clinton for Economic Policy at the White House National Economic Council. *OTS 01-43, OTS, 7/3/01.*

### ***Liquidity Requirements***

The OTS issued a final rule that removes the regulation requiring savings institutions to maintain an average daily balance of liquid assets of at least 4 percent of their liquidity base. The final rule requires thrifts to maintain adequate liquidity to ensure safe-and-sound operation. The rule, which is effective July 18, 2001, will give thrifts greater flexibility in adjusting their asset mix. *BBR, 3/19/01, p. 478; FR, 7/18/01.*

## ***Federal Housing Finance Board***

### ***Chairman Appointed***

President Bush designated J. Timothy O'Neill Chairman of the Federal Housing Finance Board on June 18, 2001. Mr. O'Neill has served as a director of the Finance Board since June 1995. Before joining the Finance Board, Mr. O'Neill was a partner in the Washington, D.C., law firm of O'Connor & Hannan, where he focused on trade and international law and legislative and regulatory issues. Mr. O'Neill was also Director of Congressional Affairs at the Finance Board in 1991 and 1992. *FHFB 01-13, FHFB, 6/19/01.*

### ***Board Member Appointed***

On December 28, 2000, President Clinton announced the recess appointment of Allan I. Mendelowitz to serve as a member of the Board of Directors for the Federal Housing Finance Board. Mr. Mendelowitz served as Chairman of the Board from December 28, 2000, until June 18, 2001, when President Bush appointed J. Timothy O'Neill as chairman. Mr. Mendelowitz served as the executive director of the U.S. Trade Deficit Review Commission from October 1999 to December 2000. From January 1999 to September 1999, he was vice president of the Economic Strategy Institution, where he supervised research on trade policy, international competitiveness, and telecommunications policy. *FHFB 00-41, FHFB, 12/28/00.*

### ***Collateral Rules Eased***

The Federal Housing Finance Board (FHFB) announced on November 30, 2000, that four regional Home Loan Banks expanded the type of loans small member banks can pledge as collateral for advances. Member banks typically have used mortgages as collateral for advances, but the Dallas, Topeka, Des Moines, and Seattle Home Loan Banks will now permit member institutions with assets less than \$500 million to use small-business, farm, and agriculture-business loans as collateral. The FHFB will permit the other Home Loan Banks to adopt similar plans at any time. *AB, 12/1/00.*

### ***Final Rule on Capital Standards***

The Federal Housing Finance Board approved a final rule on December 20, 2000, implementing a new capital structure for the Federal Home Loan Banks. The final rule replaces the FHLBanks' subscription capital structure with a more flexible, risk-based capital structure, and the rule contains risk-based and leverage-capital requirements similar to those for depository institutions. The final rule implements provisions of the Gramm-Leach-Bliley Act (GLBA) that establish two classes of capital stock: Class A, which is redeemable on six months' notice; and Class B, which is redeemable on five years' notice. The rule also incorporates the requirements that each FHLBank maintain a minimum ratio of total capital to total assets of at least 5 percent and that a FHLBank may not redeem stock if it

would fail to meet any of its minimum capital requirements. Each FHLBank may weight its permanent capital at 1.5 times paid-in value to meet the 5-percent test, as long as its total capital, excluding such weighting, is not less than 4 percent of its total assets. Each FHLBank also must have enough permanent capital to meet the rule's risk-based capital requirements for credit risk, market risk, and operations risk. GLBA requires each of the FHLBanks to submit a capital structure plan to the Finance Board for approval within 270 days of the publication of the final rule and provides for a transition period to the new capital structure of up to three years from the effective date of each FHLBank's capital structure plan. *FHFB 00-38, FHFB, 12/20/00.*

### ***Amendment to Affordable Housing Program***

On May 4, 2001, the Federal Housing Finance Board approved a rule amending its Affordable Housing Program (AHP) regulations to improve the program's effectiveness and efficiency. The most significant rule change increases the maximum amount of money that can be set aside annually under a Federal Home Loan Bank's homeownership set-aside program to the greater of \$3 million or 25 percent of a FHLBank's annual AHP contribution. Those limits previously were the greater of \$1.5 million or 15 percent of the FHLBank's annual AHP contribution. Each FHLBank independently operates an Affordable Housing Program in accordance with the FHLBank Act. Funding for each program varies by FHLBank, but banks must set aside a minimum of 10 percent of their funding for affordable housing initiatives. *FHFB 01-10, FHFB, 5/4/01; BBR, 5/14/01, p. 858.*

## ***National Credit Union Administration***

### ***Acting Chairman Appointed***

On February 8, 2001, President Bush named Dennis Dollar Acting Chairman of the NCUA Board of Directors. Mr. Dollar has been a member of the Board since October 1997. His current term expires on August 2, 2001. Before joining the NCUA, Mr. Dollar served as CEO of the Gulfport VA Federal Credit Union from 1992 to 1997. Mr. Dollar also served two terms in the Mississippi House of Representatives from 1975 to 1983. *PR020901, NCUA, 02/09/01.*



### ***Board Member Appointed***

President Clinton named Geoff Bacino to the NCUA Board of Directors in a recess appointment effective December 29, 2000. Mr. Bacino, who was originally nominated for a seat on the Board on July 24, 2000, fills the seat held by Chairman Norman E. D'Amours whose term expired August 2, 1999. Mr. Bacino was president of Bacino and Associates, a lobbying and public-relations firm in Alexandria, Virginia. He previously served as a lobbyist for the Credit Union National Association, co-founded the National Association of State-Chartered Credit Unions, and served as executive director of the National Association of Share Insurance Corporations. *PR010201, NCUA, 01/02/01.*

### ***Credit Unions Receive Dividend***

On March 8, 2001, the NCUA voted to waive an insurance premium for 2001 and pay a dividend of \$99.5 million to the nation's federally insured credit unions. The average size \$48-million credit union will receive a dividend of approximately \$11,000. The dividend returns the National Credit Union Share Insurance Fund (NCUSIF) to the normal operating level of 1.3 percent of deposits of federally insured credit unions. Since the NCUSIF was recapitalized in 1985, approximately \$552 million has been returned to federally insured credit unions in the form of dividends. *PR030801, NCUA, 3/8/01.*

## **STATE LEGISLATION AND REGULATION**

### ***Illinois***

Chicago became the first city to take local legislative action against predatory lending by passing an ordinance on August 30, 2000, that prohibits financial institutions engaged in predatory practices from acting as city depositories or contractors. The "Anti-Predatory Lending Ordinance" defines "predatory" as any loan with an annual percentage rate that exceeds the U.S. Treasury rate by more than six percentage points. The ordinance requires all city depositories and financial-services vendors to pledge that neither they nor their affiliates will engage in predatory lending. Institutions that fail to sign the pledge will be barred from city contracts. Mayor Richard Daley introduced the ordinance in an effort to curb lending practices that have contributed to unprecedented rates of foreclosures and abandonment of single-family residences in the city. *BBR, 9/11/00, p. 319-320.*

On April 17, 2001, the Illinois Joint Committee on Administrative Rules adopted regulations aimed at preventing predatory lending in Illinois. The regulations apply to high-risk loans, which are defined as: first-mortgage loans with an annual percentage rate of at least 6 percent more than the U.S. Treasury securities rate, and second-mortgage loans with an annual percentage rate of at least 8 percent greater than the U.S. Treasury securities rate. The regulations also apply to loans with total points and fees exceeding \$800 or 5 percent of the total loan, whichever is greater. When such high-risk loans are

issued, lenders are required to verify the borrower's ability to repay and are restricted from tacking single-premium credit life insurance onto the loan. The regulations impose several other restrictions on Illinois-licensed lenders, including: a prohibition on deceptive marketing and sales techniques; a ban on loan flipping; a ban on negative amortization of loans; limits on the financing of points and fees; limitations on balloon payments; and prohibitions on loans in which payments are made solely to a contractor. *BBR, 4/9/01, p. 631.*

### ***New York***

Governor George E. Pataki (R) signed a bill on September 8, 2000, that extends New York state's "wild card" banking law for another three years. The law will now expire September 10, 2003. The "wild card" legislation gives the New York State Banking Department the ability to grant state-chartered banks powers matching those powers enjoyed by federally chartered banks. The legislation is necessary to protect the viability of New York state's banking charter and New York's banking consumers. In addition to extending the expiration date, the new law strengthens consumer protection provisions by prohibiting banks from charging customers certain fees solely because the customer purchases insurance from an insurer other than the bank or one of its affiliates. *BBR, 9/25/00, p. 389.*

On November 9, 2000, the New York State Insurance Department issued a rule for safeguarding

consumers' confidential personal information. All licensed insurers are required to provide initial notice to consumers of how they share nonpublic personal financial information with unaffiliated parties, and they must provide an annual opportunity for consumers to "opt out" of having their information shared with third parties. The rule brings New York insurers into compliance with the privacy requirements of the Gramm-Leach-Bliley Act. *AB, 11/13/00.*

### ***Pennsylvania***

The Philadelphia City Council passed an ordinance on April 5, 2001, banning predatory lending in the city and requiring loan counseling for borrowers

who were charged high interest rates. The city is targeting nonbank lenders, however, and the ordinance exempts state and national banks and thrifts and trust companies. The ordinance prohibits lenders from making high-cost loans. A high-cost loan is defined as one with an interest rate more than 6.5 percentage points above the U.S. Treasury securities rate, and with total points and fees financed equal to four percentage points of the loan amount. Lenders found to be predatory will be fined and will lose all contracts with the city or city agencies. The ordinance also establishes a Predatory Lending Review Committee to investigate allegations of abusive lending and to help the victims of predatory lenders. *AB, 4/6/01.*

## **BANK AND THRIFT PERFORMANCE**

### ***Fourth-Quarter 2000 Results for Commercial Banks and Savings Institutions***

FDIC-insured commercial banks earned \$17.8 billion during the fourth quarter of 2000, which is \$1.5 billion less than third-quarter earnings, but \$91 million more than earnings in the fourth quarter of 1999. Banks' annualized return on assets (ROA) was 1.16 percent in the fourth quarter, down from 1.28 percent in the third quarter and 1.27 percent one year earlier. The number of commercial banks on the FDIC's "Problem List" increased from 75 to 76 banks during the quarter, while assets of problem banks increased from \$14 billion to \$17 billion. There were two commercial bank failures in the fourth quarter of 2000.

FDIC BIF-insured mutual savings institutions reported earnings of \$2.6 billion in the fourth quarter of 2000, up \$49 million from the third quarter, but \$90 million less than earnings one year earlier. The industry's ROA for the fourth quarter held steady from the third quarter at 0.86 percent, but was down from 0.95 percent in the fourth quarter of 1999. The number of problem thrifts increased to 18 thrifts from 15 in the third quarter, but assets of problem thrifts decreased from \$7.3 billion in the third quarter to \$7.1 billion at year-end 2000. There were no thrift failures during the fourth quarter of 2000. *FDIC Quarterly Banking Profile, Fourth Quarter 2000.*

### ***First-Quarter 2001 Results for Commercial Banks and Savings Institutions***

FDIC-insured commercial bank earnings rebounded in the first quarter of 2001—net income totaled \$19.9 billion in the quarter, up \$2.1 billion from the previous quarter and \$400 million higher than earnings in the first quarter of 2000. Commercial banks' average ROA was 1.27 percent in the first quarter of 2001, up from 1.16 percent in the fourth quarter of 2000, but down from 1.35 percent in the first quarter of 2000. The number of commercial banks on the FDIC's "Problem List" increased from 76 to 78 banks during the quarter, but assets of problem banks remained unchanged at \$17 billion. There was one bank failure during the first quarter.

FDIC BIF-insured mutual savings institutions reported earnings of \$2.9 billion in the three months from January through March 2001, which is \$300 million higher than the previous quarter but \$35 million lower than one year earlier. The industry's ROA for the first quarter was 0.95 percent, up from 0.86 percent in the fourth quarter of 2000, but down from 1.03 percent one year earlier. The number of problem thrifts declined from 18 to 17 during the quarter, and problem assets decreased from \$7.1 billion to \$6.1 billion. There were no thrift failures during the first quarter of 2001. *FDIC Quarterly Banking Profile, First Quarter 2001.*

## **RECENT ARTICLES AND STUDIES**

A report released by the OCC on October 27, 2000, says that the number of national banks offering online financial services on Internet sites increased

by 52 percent from September 1999 to July 2000. The percentage of national banks allowing customers to transact business on their Web sites

increased from 21 percent in September 1999 to 32 percent in July 2000. In addition, although smaller national banks (banks with less than \$100 million in assets) still lag behind larger banks, the percentage of small banks offering transactional Internet services increased from 7 percent to 17 percent during the period studied. *BBR*, 11/6/00, p. 587.

An October 2000 report by the Federal Reserve Bank of Cleveland suggests a merger of the two federal deposit insurance funds would reduce costs to taxpayers and would not present a risk to the financial-services industry. James B. Thompson, an economist at the Federal Reserve, reports that financial market integration has effectively removed economic distinctions between depository institutions and the risks they face, making it difficult to argue that banks and savings associations operate in distinct markets with widely different types of risk exposure. The author points out that nearly one-half of bank loans are related to real estate and that more than 12 percent of loans made by thrifts are consumer loans or commercial and industrial loans. In addition,

almost 40 percent of SAIF-insured deposits originate with commercial banks, while savings association deposits make up 9 percent of BIF accounts. The report, entitled "Two Deposit Insurance Funds Are Not Necessarily Better Than One," was published in the Federal Reserve Bank of Cleveland's *Economic Commentary*. *BBR*, 1/16/01, p. 57–58.

On April 25, 2001, the Bank for International Settlements issued a report on the role of stress testing in financial institutions' risk-management activities. The report, entitled *A Survey of Stress Tests and Current Practice at Major Financial Institutions*, was prepared by a task force formed under the Committee on the Global Financial System (CGFS) of the central banks of the Group of Ten countries. In early 2000, the CGFS conducted a survey of stress-testing scenarios used at 43 major financial institutions, including both commercial and investment banks, in ten countries. The survey results implied that stress testing has become an integral part of banks' risk-management practices. *BBR*, 4/30/01, p. 768–769.

## INTERNATIONAL DEVELOPMENTS

### *Basel Committee*

The Basel Committee on Banking Supervision on September 14, 2000, issued revised guidelines on credit risk in banking. The guidelines were introduced by the Basel Committee initially in July 1999, but have been slightly altered in order to reflect comments made from industry representatives. The guidelines set out 17 principles for assessing banks' management of credit risk, covering areas such as: establishing an appropriate credit-risk environment, operating under a sound credit-granting process, maintaining an appropriate credit administration, ensuring adequate controls over credit risk, and spelling out the role of supervisors in overseeing bank credit-risk-management efforts. The guidelines are contained in two papers, entitled *Principles for the Management of Credit Risk* and *Best Practices for Credit Risk Disclosure*. *PR-FRB*, 9/14/00; *BBR*, 9/18/00, p. 375.

### *Wolfsberg Anti-Money Laundering Principles*

On October 30, 2000, a multinational coalition of 11 private banks announced a set of voluntary guidelines aimed at curbing money laundering. The guidelines call for bank officials to exercise due diligence when opening accounts or performing transactions for customers by collecting and recording specific information regarding the identities of account-holders and the sources of their funds. Specifically, the guidelines state that the banks should collect hard data on the following: the purpose and reasons for opening a bank account; anticipated account activity; the source of wealth; the source of funds; the estimated account net worth; and references or other sources to corroborate reputation information. The banks agreeing to the guidelines are ABN AMRO Bank, Barclays Bank, Banco Santander Central Hispano, S.A., Chase Manhattan Private Bank, Citibank, N.A., Credit Suisse Group, Deutsche Bank AG, HSBC, J.P. Morgan, Societe Generale, and UBS AG. *BBR*, 11/6/00, p. 581.